



Marian Dyer  
Vice President-Federal Regulatory

SBC Telecommunications, Inc.  
1401 I Street, N.W.  
Suite 1100  
Washington, D.C. 20005  
Phone 202 326-8835  
Fax 202 408-4805

DOCKET FILE COPY ORIGINAL

September 1, 2000

RECEIVED

SEP - 1 2000

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Ms. Magalie Salas  
Secretary  
Federal Communications Commission  
Room TW-A325, The Portals  
445 Twelfth Street, S. W.  
Washington, DC 20554

RE: In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor, To SBC Communications, Inc., Transferee, (CC Docket No. 98-141)

Dear Ms. Salas:

Pursuant to Appendix C (Merger Conditions) regarding SBC Communications Inc.'s (SBC) compliance with the SBC/Ameritech Merger Conditions, SBC submits herein the report of its independent auditor, Ernst & Young LLP (EY). EY reports on the procedures agreed to by management of SBC and the Federal Communications Commission (FCC) covering the period October 8, 1999 through December 31, 1999.

Once SBC has had an opportunity to thoroughly conduct a review of this report and the auditor's work papers, SBC will be prepared to respond to or otherwise address any issues contained in them.

Sincerely,

Attachments

cc: Ms. Carol Matthey  
Mr. Anthony Dale  
Mr. Hugh Boyle  
Mr. Mark Stephens

No. of Copies rec'd 0  
List ABCDE

## Report of Independent Accountants on Applying Agreed-Upon Procedures

To the Management of SBC Communications Inc.

We have performed the procedures enumerated below, which were agreed to by management of SBC Communications Inc. ("SBC") and the Federal Communications Commission ("FCC"), solely to assist in evaluating management's assertion that SBC complied with the separate affiliate requirements set forth in Section I of Appendix C of the FCC's Order approving the SBC/Ameritech Merger, CC Docket 98-141, released October 8, 1999 ("Separate Affiliate Requirements"), during the period from October 8, 1999 through December 31, 1999 ("the Evaluation Period"). This engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described in Appendix A either for the purpose for which this report has been requested or for any other purpose.

The procedures performed for the Evaluation Period and the results obtained are documented in Appendix A. These procedures and the resulting findings are not intended to be an interpretation of any legal or regulatory rules, regulations or requirements.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on SBC's compliance with the Separate Affiliate Requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of management of SBC and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record and its distribution is not limited.

*Ernst & Young LLP*

August 31, 2000

## **APPENDIX A**

### **Results of Agreed-Upon Procedures**

The definitions of the following terms are documented in Appendix B: Advanced Services, Advanced Services Affiliate(s), Advanced Services Equipment, Ameritech States, Assets, ILECs, Merger Close Date, Merger Conditions, Official Services and SBC States.

- 1) Inspected the certificates of incorporation and bylaws of the Advanced Services Affiliates and determined that each Advanced Services Affiliate was established as a Delaware corporation separate from the ILECs. Delaware corporations are not required to file articles of incorporation, and as such, no articles of incorporation exist.
- 2) Obtained and inspected the SBC corporate organizational charts as of December 16, 1999 and confirmed with legal representatives of the ILECs and Advanced Services Affiliates the legal, reporting and operational corporate structure of the Advanced Services Affiliates. Determined the Advanced Services Affiliates were independent from the ILECs and documented who owned the Advanced Services Affiliates and to whom they reported.
- 3) Obtained a functional organizational chart for each Advanced Services Affiliate as of December 31, 1999 and obtained SBC's documentation for each department of the number of employees, street addresses where employees were located and description of functions performed by location.
- 4) Obtained from the Advanced Services Affiliates a list and description of services rendered to each Advanced Services Affiliate by the ILECs and other ILEC affiliates during the Evaluation Period.
- 5) Obtained the December 31, 1999 balance sheet of each Advanced Services Affiliate and detailed listings of all fixed assets including capitalized software ("detailed listings") and compared the amount shown on the detailed listings with the amount shown in the balance sheets. Documented SBC's explanations for reconciling differences between the detailed listings and the amounts shown on the balance sheets and noted one Advanced Services Affiliate (AADS) had \$192,046 of reconciling differences which were not explained by SBC. SBC indicated that this amount resulted from erroneous manual journal entries, and was detected and adjusted by Advanced Services Affiliate personnel in April 2000. The Advanced Services Affiliate plans to implement an automated fixed asset system in 2000 to eliminate such occurrences.

## APPENDIX A

Noted that the detailed listings included for each asset, description, location, date of purchase, and price paid and recorded, and for those items purchased on or after the Merger Close Date, noted each asset included a notation as to whether it was acquired from an ILEC, affiliate or nonaffiliate.

Selected a random sample of 100 assets from the detailed listings and noted supporting documentation revealing ownership was not available for 17 assets at AADS, all of which were acquired prior to 1997. Replacements were selected by additional random sampling for these items, for which supporting documentation was not available for 7 assets acquired in 1997 or prior. Additional replacements were selected until documentation was successfully obtained for 100 assets.

For those assets for which support was obtained, no instances of joint ownership between the Advanced Services Affiliate and the ILECs were noted in the samples. For those assets for which supporting documentation was not obtained, we were unable to determine joint ownership.

- 6) Obtained the general ledger of each Advanced Services Affiliate as of December 31, 1999 and noted that the Advanced Services Affiliates maintained general ledgers separate from the ILECs. Reviewed the general ledgers for special codes to link the Advanced Services Affiliates' general ledgers to the general ledgers of the ILECs and noted none.
- 7) Obtained/documented the accounting procedures and policies utilized by each Advanced Services Affiliate during the Evaluation Period. This documentation included our understanding of the accounting systems, processes, transaction flows and control points affecting revenue, accounts receivable, cash receipts, purchasing, accounts payable, cash disbursements, payroll, fixed assets and recording of affiliate transactions.
- 8) Performed one walk-through at each Advanced Services Affiliate of a cash receipt, cash disbursement and payroll transaction and noted the transactions were appropriately reflected in the general ledger of each Advanced Services Affiliate.
- 9) Obtained each Advanced Services Affiliate's financial statements and a listing of lease agreements as of December 31, 1999. Noted one lease on the list for which the annual obligation indicated was \$500,000 or more and determined that the lease was accounted for in accordance with generally accepted accounting principles. Determined that the Advanced Services Affiliates' lease accounting policies were consistent with generally accepted accounting principles.

## APPENDIX A

- 10) Obtained the Advanced Services Affiliates' equipment and software contracts as of December 31, 1999. Identified and documented contracts for which the annual obligation was \$500,000 or more, or for which purchases exceeded \$500,000 during the Evaluation Period. Judgmentally selected two invoices at each Advanced Services Affiliate from vendors that the Advanced Services Affiliate purchased in excess of \$500,000 during the Evaluation Period and traced the amount of the purchase of Advanced Services Equipment to the general ledgers of the Advanced Services Affiliates without exception.
- 11) Obtained the ILECs' and Advanced Services Affiliates' policies and procedures for transferring, sharing and loaning employees between each other and identified the types of controls that SBC indicated were in place during the Evaluation Period to prevent one from being an officer, director or employee of both the ILEC and the Advanced Services Affiliate at the same time.
- 12) Inquired and noted that the Advanced Services Affiliates and the ILECs maintain separate boards of directors and separate officers. Obtained a list of officers' and directors' names for the ILECs and Advanced Services Affiliates for the Evaluation Period and compared and documented the names appearing on both lists. Noted that for the period October 8, 1999 through the date ADSI merged into ASI on December 20, 1999, four individuals' names appeared on both an ILEC and ADSI list. SBC management represented that ADSI is not an Advanced Services Affiliate as defined in the Merger Conditions and therefore is not subject to the requirement to maintain separate officers and directors from the ILECs.

Read the minutes of the meetings of the board of directors for each ILEC and each Advanced Services Affiliate for the Evaluation Period and compared and documented the names appearing on the minutes of the ILECs and each Advanced Services Affiliate. Noted two individuals' names appeared in the minutes of both an ILEC and an Advanced Services Affiliate within the Evaluation Period. On August 8, 2000, we received confirmation from the individuals involved that as of October 31, 1999, it was the agreement and understanding between the respective ILECs and the individuals that these individuals had resigned their previous positions. This date was prior to the date they became an officer or director of the Advanced Services Affiliate.
- 13) Obtained the functional organizational chart for each Advanced Services Affiliate at December 31, 1999 and determined that no departments report either functionally or administratively (directly or indirectly) to an officer of the ILECs.

## APPENDIX A

- 14) Obtained files containing the year-to-date payroll information for each Advanced Services Affiliate and each ILEC that included the social security numbers of all the directors, officers and employees as of December 31, 1999. Designed and executed a program which compared social security numbers of directors, officers and employees and prepared a list of those appearing on both the Advanced Services Affiliates' payroll and the ILECs' payroll. For all 19 names appearing on the prepared list, obtained detailed payroll records and verified through comparison between the payroll records that no one was simultaneously on both an ILEC payroll and an Advanced Services Affiliate's payroll during the Evaluation Period.
- 15) Obtained a list of officers and employees who transferred from the ILECs to the Advanced Services Affiliates on or after the Merger Close Date and determined that SBC's controls inspected in Procedure 11 were implemented by testing a sample of two employees transferred from each ILEC, or all employees transferred if fewer than two. Obtained written confirmation from those employees and determined that they had been trained on the use of proprietary information.
- 16) Reviewed each Advanced Services Affiliate's contracts with major suppliers of goods and services and noted no guarantees or recourse to the ILECs' assets, either directly or indirectly through an affiliate. Major suppliers were defined as those having \$500,000 or more in annual sales to the Advanced Services Affiliate. Noted no debt agreements/instruments or credit arrangements with lenders or major suppliers.
- 17) As there were no Advanced Services Affiliate lease agreements given to us where the annual obligation was \$500,000 or more, no testing was performed to determine whether the Advanced Services Affiliates' lease agreements had recourse to the ILECs' assets, either directly or indirectly through another affiliate. Also reviewed the listing of Advanced Services employee work locations obtained in **Procedure 3** and noted that the Advanced Services Affiliates' employee work locations were either covered under a lease agreement or owned outright by one of the Advanced Services Affiliates, except for the following:
  - Two employees working from home
  - One location in which an employee worked in the space of a nonaffiliated company pursuant to the terms of a maintenance contract with that company
  - Six locations in space owned or leased by nonregulated affiliates; SBC has indicated that it either has moved the employees from these locations or will establish lease agreements and bill the corresponding balances
  - Three locations in space owned by ILECs; SBC has indicated that it either has moved the employees from these locations or will establish affiliate agreements and bill the corresponding balances (AADS)

## APPENDIX A

- 18) Reviewed the contracts obtained in **Procedure 10** and noted there were no instances in which an Advanced Services Affiliate's contract (where the annual obligation or purchases exceeded \$500,000) granted recourse to the ILECs' assets, either directly or indirectly through another affiliate.
- 19) Obtained positive confirmation from lessors attesting to the lack of recourse to the ILECs' assets for a judgmental sample of ten Advanced Services Affiliates' leases with an annual obligation less than \$500,000. There were no leases with an annual obligation greater than \$500,000. SBC indicated there were no loans or credit arrangements outstanding at any Advanced Services Affiliate during the Evaluation Period.
- 20) Obtained documentation of the balance of accounts payable to and/or advances from the ILECs as of December 31, 1999 for each Advanced Services Affiliate.
- 21) Documented the procedures used by the ILECs and the Corporate Compliance Officer to identify, track and respond to complaints relating to alleged noncompliance with the Advanced Services provisions of the SBC/Ameritech Merger Conditions, including written complaints submitted directly to the ILECs, written complaints submitted indirectly to the ILECs through their parents and affiliates, written complaints submitted to the ILECs in connection with regulatory complaint processes and oral complaints made through official complaint channels made available to competitors and other complainants. Obtained from the ILECs and the Corporate Compliance Officer a list of all documented complaints involving alleged noncompliance with the Advanced Services provisions of the SBC/Ameritech Merger Conditions, including post merger complaints submitted by competitors related to the provision or procurement of goods, services, facilities and information, or in connection with the establishment of standards. This list groups the complaints in the following categories:
  - Allegations of cross-subsidies;
  - Allegations of discriminatory provision or procurement of goods, services, facilities or customer network services information (excludes customer proprietary network information ("CPNI")) or the establishment of standards;
  - Allegations of discriminatory processing of orders for, and provisioning of, unbundled network elements, and discriminatory resolution of network problems;
  - Allegations of discriminatory availability of unbundled network elements; and
  - Allegations of discriminatory availability of facilities or services not at the same rates and not on the same terms and conditions as the separate Advanced Services Affiliate.

## APPENDIX A

For each group of complaints, determined by inquiry and documented SBC's response as to how many of these complaints were under investigation, how many complaints had been resolved and in what time frame they had been resolved. For those complaints that had been resolved, obtained SBC's documentation of how those allegations were concluded and, if the complaint was upheld, inquired and obtained SBC's documentation of what steps the company had taken to prevent those practices from recurring.

- 22) Obtained from the ILECs and each Advanced Services Affiliate current written procedures for transactions with affiliates and compared these procedures with the FCC Rules and Regulations, including: 32.27; 53. (203(e)); 64.901; paragraphs 122, 124, 183 and 265 of the *Report and Order* in CC Docket No. 96-150, issued December 1996, concerning Accounting Safeguards Under the Telecommunications Act of 1996 (11 FCC Rcd 17539 (1996)); paragraph 193 of the "First Report and Order and Further Notice of Proposed Rulemaking" in CC Docket 96-149, issued December 1996, concerning Non-Accounting Safeguards under Sections 271 and 272 of the Communications Act of 1996; and paragraph 337 of the Memorandum Opinion and Order in CC Docket No. 98-121, issued October 13, 1998, concerning BellSouth's 271 application in Louisiana. Noted no exceptions.
- 23) Inquired and documented how the ILECs and each Advanced Services Affiliate disseminate the FCC Rules and Regulations and the conditions of the Merger Agreement and raise awareness among employees for compliance with the rules listed in Procedure 22 above and the Merger Conditions. This documentation includes a description of the type and frequency of training, literature distributed, company's policy and the supervision employees responsible for ensuring compliance with these rules receive. Interviewed employees responsible for the development and recording of transactions affected by these rules in the books or records of the carrier and determined they were aware of the rules listed in Procedure 22.
- 24) Inquired and documented the process that an Advanced Services Affiliate must follow to request any type of service from the ILECs, including the approval process within the ILECs to fulfill a request for service from an Advanced Services Affiliate. Noted that one Advanced Services Affiliate (ASI) requests services directly from the department that provides the service at certain ILECs.



## APPENDIX A

25) Obtained all written agreements, including all interconnection agreements, for services and for equipment/facilities between the ILECs and each Advanced Services Affiliate which were in effect during 1999 on or after the Merger Close Date. Documented relevant pages that describe names of parties, type of service, price, terms and conditions. Compared these agreements with the list of services provided by the ILECs to the Advanced Services Affiliates in **Procedure 4** and noted approximately \$2,200 in legal services was provided by SWBT to ASI for which no underlying affiliate agreement existed and approximately \$2,900 in legal services was provided by SWBT to ADSI for which no underlying affiliate agreement existed; an affiliate agreement that covered these services was initiated by SWBT and made public on March 13, 2000. In addition, noted which agreements were still in effect as of December 31, 1999. No agreements were terminated during the Evaluation Period. Inquired and documented that the ILECs' policy is to not provision services to the Advanced Services Affiliates without a written agreement.

26) Inquired and determined that all interconnection agreements between the Advanced Services Affiliates and the ILECs had been publicly disclosed, including prices, discounts, terms and conditions. Documented that SBC's policy is to disclose all interconnection agreements on the Advanced Services Affiliates' publicly available home page on the Internet, on the web site of the state public service commission or through public filing with the state public service commission.

27) For all written agreements between the ILECs and each Advanced Services Affiliate, excluding interconnection agreements, agreed the prices and terms and conditions of services and assets shown on the Company's home pages on the Internet to the written agreements provided in **Procedure 25**. By physical inspection, determined that the same information was made available for public inspection at the principal place of business of the ILECs. The company made no claims of confidentiality for nondisclosure, and therefore no testing was required to obtain details. Noted SBC did not post written agreements between the ILECs and ADSI on the Company's home page on the Internet and did not make such information available for public inspection. SBC management represented that ADSI is not an Advanced Services Affiliate as defined by the Merger Conditions and therefore is not subject to the requirement to post written agreements and make such information available for public inspection.

Inquired and documented the procedures that the ILECs have in place for posting affiliate transactions on a timely basis. Determined that the information provided on the Internet was sufficiently detailed and complied with accounting rules listed in Procedure 22. Obtained copies of these public postings.

## APPENDIX A

- 28) For nontariffed services and for services for which a prevailing market price ("PMP") has not been established, or which are not subject to agreements filed with a public service commission, documented the ILECs' and the Advanced Services Affiliates' process for developing fully distributed cost ("FDC"). Documented and identified the type of costs included in FDC and documented SBC's calculation of FDC for two services provided by each ILEC to an Advanced Services Affiliate and by each Advanced Services Affiliate to an ILEC. If fewer than two services existed at FDC between an ILEC and an Advanced Services Affiliate, obtained documentation of the calculation of FDC for all such services.
- 29) For nontariffed services for which a PMP has not been established, or which are not subject to agreements filed with a public service commission, documented the process the ILECs and the Advanced Services Affiliates follow to make an estimate of fair market value ("FMV"). Obtained documentation of the calculation of the estimate of FMV for two services provided by each ILEC to an Advanced Services Affiliate and by each Advanced Services Affiliate to an ILEC. If fewer than two services existed at FMV between an ILEC and an Advanced Services Affiliate, obtained documentation of the calculation of the estimate of FMV for all such services.
- 30) Obtained a listing and amounts of all services rendered by month by each ILEC to each Advanced Services Affiliate on or after the Merger Close Date and noted that no services, other than transitional services permitted by the Merger Conditions, were made available to the Advanced Services Affiliates that were not made available to third parties. For a sample of seven services selected by the users, compared unit charges to PMP, or FDC, or FMV, as appropriate, and determined that these amounts were recorded in the books of the ILECs in accordance with the affiliate transaction standards.
- 31) Obtained a listing of all services rendered by month to each ILEC by each Advanced Services Affiliate on or after the Merger Close Date. For all services provided during the Evaluation Period, compared unit charges to tariff rates, or PMP, or FDC, or FMV, as appropriate, and determined that expense for these services was recorded in the books of the ILECs in accordance with the affiliate transaction standards. Noted that for one service, the ILECs (Ameritech) were charged the rounded amount of \$21.00 during each month of the Evaluation Period, while the FDC was calculated at \$21.17.
- 32) Inquired and documented how and who maintains each Advanced Services Affiliate's employee benefit plans (such as life insurance, health insurance, retirement plans). Determined by inquiry who pays or funds these benefit plans and that the costs for administering these plans are allocated to the Advanced Services Affiliates.

## **APPENDIX A**

- 33) Obtained a listing and amounts of services rendered by month by each affiliated administrative services organization to each Advanced Services Affiliate on or after the Merger Close Date and documented the methodology used to identify and cost these services. Selected two services provided to each Advanced Services Affiliate that represented the highest dollar value in the population for the Evaluation Period. Obtained evidence that the services were billed to each Advanced Services Affiliate and that such affiliates paid for these services.
- 34) Obtained the December 31, 1999 balance sheet of each Advanced Services Affiliate and a detailed listing of all fixed assets including capitalized software as documented in Procedure 5 above. From review of the detailed listing and representation from management, noted no items were purchased or transferred from the ILECs during the Evaluation Period and noted no items were purchased or transferred from another affiliate during the Evaluation Period.
- 35) From a listing of services priced pursuant to Section 252 (e) (i.e., as approved by the regulatory commissions) or statement of generally available terms pursuant to Section 252 (f), selected by random sample, where applicable, one invoice each received from each ILEC by the Advanced Services Affiliates for the Evaluation Period. Compared the price the ILECs charged the Advanced Services Affiliates for all services on each selected invoice to the stated price in the interconnection agreement without exception.
- 36) Inquired as to whether any part of the ILECs' Official Services network was transferred or sold to an Advanced Services Affiliate during the Evaluation Period and were informed that no such transfer or sale took place.
- 37) Inquired as to whether any ILEC facilities were either sold or transferred to an Advanced Services Affiliate during the Evaluation Period and were informed that no sales or transfers took place.
- 38) Obtained the ILECs' written procurement procedures, practices and policies for purchases of services and goods including services and goods provided by the Advanced Services Affiliates. Obtained details of the ILECs' bidding process and vendor selection process, and the ILECs' process for disseminating requests for proposals ("RFPs") to affiliates and third parties. Noted that there were no stated purchasing preferences contained in the ILECs' procedures and processes.
- 39) Obtained representation from SBC that there were no procurement awards by the ILECs to any Advanced Services Affiliate for any goods or services during the Evaluation Period.

## APPENDIX A

- 40) Obtained a list of all equipment (including software), furniture, fixtures, services, facilities and customer network services information (e.g., loop makeup information and subscriber list information), excluding CPNI as defined in Section 222(f)(1) of the Communications Act of 1934, as amended, made available to each Advanced Services affiliate by the ILECs, excluding services and facilities provided pursuant to interconnection agreements. For a sample of 19 services and facilities selected by the users, inquired and obtained copies of the media used (Internet postings) by the ILECs to inform unaffiliated entities of the above-mentioned transactions.
- 41) Determined that other than services covered under the Advanced Services Affiliates' interconnection agreements with the ILECs, no unaffiliated entities had purchased the same goods (including software), services, facilities and customer network services information (excluding CPNI) from the ILECs as the Advanced Services Affiliates.
- 42) Inquired and documented the ILECs' procedures for disseminating information about network changes, establishing or adopting new network standards and making available new network services to each Advanced Services Affiliate and to unaffiliated entities. Determined that no differences existed between the procedures used to notify Advanced Services Affiliates and unaffiliated entities.
- 43) Obtained, inspected and documented the ILECs' and Advanced Services Affiliates' customer service representatives' scripts for inbound and outbound calls establishing new services, adding a second line or moving to a new location, or for any other situation where the ILECs or ILEC-affiliated sales agents attempt to market the services of the Advanced Services Affiliate or the Advanced Services Affiliate attempts to market the services of the ILECs.
- 44) Where Advanced Services orders should be placed by the separate Advanced Services Affiliate as defined by the Merger Conditions (see Merger Conditions paragraphs 6a, 6b and 6d), observed by listening in to a sample of 92 service representatives in 19 separate locations of the ILECs and Advanced Services Affiliates responding to inbound callers and outbound callers to whom the sales representatives attempt to market the Advanced Services of the Advanced Services Affiliate. Documented the messages conveyed during the observation. If an order was taken for an Advanced Service by the ILEC's service representative, determined and documented that the service representative referred the information necessary for placement of the order to the Advanced Services Affiliate.

## APPENDIX A

- 45) Where Advanced Services orders should be placed by the separate Advanced Services Affiliate as defined by the Merger Conditions (see Merger Conditions paragraphs 6a, 6b and 6d), observed the processing of service orders at a processing center by the Advanced Services Affiliates. Inquired and documented that the Advanced Services Affiliates use the same interfaces for placing Advanced Services orders with the ILECs as are made available to unaffiliated providers of Advanced Services. As part of this process, inquired and were informed that the Advanced Services Affiliates and unaffiliated providers of Advanced Services had access to the same customer-specific information for preordering and ordering, other than credit history, that is available to the ILECs through the same interfaces that are made available to the ILECs.
- 46) Obtained a list of all applications filed by an Advanced Services Affiliate (AADS) during the Evaluation Period. For a random sample of 25 collocation applications selected from this list, obtained the application and documented in our working papers which Advanced Services Affiliate filed the application, the location, collocation type and date of application. Additionally, for 9 of the 25 in this sample, vouched payment of nonrecurring charges for placing the equipment into service to treasury records and traced the payment to the respective ILEC's general ledger. Noted that payment had not been made for nonrecurring charges for 16 of the applications. The ILEC indicated that due to an error in the billing process in the Former Ameritech States, bills were not issued in some instances to either the Advanced Services Affiliate or nonaffiliated Competitive Local Exchange Carriers for collocation services of the same type.

SBC indicated that collocation applications for one of the Advanced Services Affiliates were not required to be filed during the Evaluation Period. The Company's understanding is set forth in the Company's letter dated February 15, 2000 (letter from Mr. Michael Kellogg on behalf of the Company to Ms. Carol Matthey of the FCC), and is based on the collocation transition mechanisms contained in subparagraphs I(3)(c)(3), I(3)(d), I(3)(e), I(4), I(4)(a)(3), I(4)(n)(4), I(6) and I(6)(g) in the Merger Conditions.

Obtained a list of all locations where Advanced Services Equipment was placed by the Advanced Services Affiliates during the Evaluation Period and compared this list to the list of all applications filed by the Advanced Services Affiliates during the Evaluation Period. Noted that none of the collocation applications filed by the Advanced Services Affiliates during the Evaluation Period were completed and provisioned during the Evaluation Period; thus there were no common items found on both lists.

## APPENDIX A

Obtained a copy of the October 22, 1999 "Deployment Plan" (SBC's planning document for the rollout of Advanced Services by central office) and documented the central offices where SBC indicated that Advanced Services Equipment had been placed during the Evaluation Period.

- 47) Inquired and noted that the ILECs, where applicable (Ameritech), were reporting, for each state, the performance measurements for the Advanced Services Affiliates as required by paragraph 10 of the Separate Affiliate Requirements. Noted by inquiry these measurements were reported on a separate basis from the CLEC information.

Obtained a list of the Advanced Services provided, by state, by the Advanced Services Affiliates and the ILECs during the Evaluation Period. Also, inquired and documented that voice grade services were not being provided by the Advanced Services Affiliates in any state.

- 48) Obtained a report which summarized the performance measurement data identified in Procedure 47 above by ILEC, CLECs aggregated without the Advanced Services Affiliates and Advanced Services Affiliate for the fourth quarter of 1999, and performed the following procedures:

- Compared ILECs' service intervals to service intervals provided to CLECs and documented which results did not demonstrate parity or benchmark performance as defined by the business rules in Attachments A through A-3 of the Merger Conditions. For the measurements that did not meet parity or benchmark performance, documented SBC's explanation for the cause of the variation. Also, obtained documentation from SBC indicating what actions have been taken to provide parity or benchmark performance in the future.
- Compared service intervals provided to the Advanced Services Affiliates to the service intervals provided to the CLECs and documented in which performance measures the affiliates' treatment varied from that received by the CLECs in excess of plus or minus 5 percent. For those items with results that showed greater than 10 percent variation, inquired and documented SBC's explanation for the cause of the variation. Also, obtained documentation from SBC indicating what actions have been taken to provide comparable performance in the future.

## APPENDIX A

- 49) Inquired and documented how the ILECs provide individual CLECs with performance measures per Sec. 272(e)(1) for the ILECs and the Advanced Services Affiliates. Obtained the performance measures report that the ILECs used for exchange access service intervals and obtained documentation from SBC regarding internal controls on the systems and methodology used to calculate these measures at each of SBC's ILECs.

Obtained the raw data from the intermediate systems and recalculated Performance Measurement Two, "Time from Bell Operating Company Promised Due Date to Circuit Being Placed in Service for DS3 and Above Circuits," for December 1999 for Texas, Illinois and Connecticut and compared the outcome to the ILEC's results.

The following differences were noted when recalculated results were compared to the ILEC's results:

- Texas – The population used for the recalculation of the nonaffiliate disaggregation for Performance Measurement Two contained 14 additional orders (total population for recalculation was 246) for DS3 and above circuits than the population used by the Company in its calculation due to an error in SBC's query used to calculate Performance Measurement Two. Additionally, we noted Southwestern Bell Telephone Company's methodology for excluding orders missed due to customer reasons from both the numerator and denominator of the calculation differed from the methodology used by Ameritech and SNET.

Upon correction of the query and the change in the treatment of orders missed due to customer reasons, the results of our recalculation matched those of the Company for both affiliate and nonaffiliate orders. SBC corrected the above errors in the calculation of the Texas results and restated the December 1999 results and implemented these changes.

- Connecticut – The Company's calculation of the affiliate disaggregation for Performance Measurement Two reported that five of six orders were completed on time or missed due to customer reasons. Our recalculation indicated nine of nine orders were completed on time or missed due to customer reasons. In addition, the Company's calculation of the nonaffiliate disaggregation for Performance Measurement Two reported that seven of eight orders were completed on time or missed due to customer reasons. Our recalculation indicated that 16 of 18 orders were completed on time or missed due to customer reasons.

## APPENDIX A

The differences in the Connecticut calculation were due to an error in the Company's reference table used by the query for product classification and an error in the ACNA table used by the query to classify affiliate and nonaffiliate. SBC corrected the above errors in the calculations of the Connecticut results and restated the December 1999 results and implemented these changes.

- 50) Obtained the written agreements offered to each Advanced Services Affiliate (excluding interconnection agreements). Obtained a list of all services offered by the ILECs and compared this list with the list of services obtained in **Procedure 4** and documented on the list whether each service was offered through a written agreement. The results of this procedure were identical to those noted in **Procedure 25** above.
- 51) Obtained a list of all agreements (e.g., written agreements, affiliate agreements, etc., excluding interconnection agreements) signed as of December 31, 1999 between the ILECs and the Advanced Services Affiliates and between the ILECs and unaffiliated companies, separately for each state. E&Y compared rates, terms, and conditions for ten unaffiliated billing and collection agreements to the agreement offered to one Advanced Services Affiliate (ASI) and documented differences.
- 52) Inquired and documented that there were no occurrences of a nonaffiliated CLEC requesting to opt-in ("MFN") to an interconnection agreement that an ILEC had with an Advanced Services Affiliate.
- 53) Obtained invoices for access to unbundled network elements ("UNEs") for the month of December 1999 rendered by each ILEC to each Advanced Services Affiliate, where applicable, and other providers of Advanced Services. From the invoices obtained for the Advanced Services Affiliates that purchased unbundled network elements during 1999, inspected underlying details of five randomly selected invoices to the Advanced Services Affiliate from ILECs providing UNEs. For UNEs billed on these invoices, compared the rates, terms and conditions charged to each Advanced Services Affiliate with rates, terms and conditions charged to other providers of Advanced Services for the same services for a judgmental sample of ten other providers of Advanced Services. Noted no exceptions.
- 54) Using the invoices obtained in Procedure 53, determined through examination of invoices, payment vouchers and ILEC general ledger extracts that the amount invoiced for access to unbundled network elements to each Advanced Services Affiliate agreed to the amount recorded by the ILEC and paid by each Advanced Services Affiliate.



## APPENDIX A

- 55) Inquired and documented that three ILECs offered billing and collection services to an Advanced Services Affiliate pursuant to written agreement that contained the elements described in the procedures by the users. Identified the billing and collection categories and elements offered and agreed these elements to those specified in the procedures by the users.
- 56) For the three ILECs that offered billing and collection services to an Advanced Services Affiliate during the Evaluation Period, obtained the written agreements and documented the various billing and collection categories and elements offered, including rates and conditions.
- 57) Inquired and documented the Advanced Services Affiliates' and each ILEC's procedures designed to ensure all purchases of Advanced Services Equipment, including associated software, were recorded on the books of the Advanced Services Affiliate for the portion of the 1999 Evaluation Period in excess of 30 days past the Merger Close Date.

Obtained a listing of all Advanced Services Equipment, including associated software, installed on or after the Merger Close Date at each of the ILECs ("ILEC Listing") and the Advanced Services Affiliates ("Advanced Services Affiliate Listing") and performed the following:

- Noted that SBC indicated \$3.7 million of Advanced Services Equipment, which should have been recorded on the books of an Advanced Services Affiliate (ASI), was recorded on the books of the ILECs during the Evaluation Period. Noted that this matter was identified and corrected by SBC prior to the performance of these agreed-upon procedures. SBC indicated that there was no other Advanced Services Equipment installed or recorded at the ILECs.
- Selected 100 random purchases from the Advanced Services Affiliate Listing on or after 30 days after the Merger Close Date and reviewed documentation that indicated the Advanced Services Affiliates purchased this equipment. Noted that supporting invoices for 31 of the 100 purchases indicated that an ILEC was billed by a vendor. The ILECs and Advanced Services Affiliate (ASI) indicated that this situation arose because the Advanced Services Affiliate used the ILECs' Custom Work Order-like process to render vendor payment and establish a property record; this was done because, per SBC management, the Advanced Services Affiliate was not able to develop an accounting system sufficient for that purpose in 1999. The ILECs and Advanced Services Affiliate indicated that the purchase

## APPENDIX A

price was prepaid by the Advanced Services Affiliate to the ILECs and that the Advanced Services Affiliate was in fact the only entity which purchased, owned and had the assets recorded on its books at any period-end. This process was performed subject to the terms of a written affiliate agreement.

Obtained and documented the ILECs' and Advanced Services Affiliates' policy for capitalizing versus expensing Advanced Services Equipment costs.

Selected the month of December 1999 and obtained ILEC expense detail for expense accounts (list actual expense accounts). From the ILEC expense detail, selected a sample of 100 items and reviewed purchase orders noting that the items selected were not considered Advanced Services Equipment, as defined, and were appropriately recorded on the ILECs' books. Noted that one ILEC's books included items procured for an Advanced Services Affiliate under the Custom Work Order-like process described above; noted that expenses related to these items were appropriately reversed from the ILEC's books within the month in which they were procured.

- 58) Obtained the ILECs' policies and procedures for the sales forces' taking of orders and forwarding of orders to the Advanced Services Affiliates. For those Advanced Services Affiliates that offered Advanced Services during the Evaluation Period, obtained and inspected training materials provided to ILEC sales representatives and were informed that ILEC sales representatives receive training on the procedures to be used to take an order and that placement of orders is prohibited.
- 59) Inquired and documented SBC's response that no customer accounts were transferred from the ILECs to the Advanced Services Affiliates during the Evaluation Period.
- 60) Inquired and documented SBC's response that the ILECs did not transfer to the Advanced Services Affiliates a facility that was deemed to be an unbundled network element under 47 U.S.C. Section 251(c)(3) during the Evaluation Period.
- 61) Inquired and documented SBC's response that certain employees of the Advanced Services Affiliates are located within the same buildings as employees of the ILECs. Obtained and inspected training and other materials that the Company provides to employees to ensure transactions between the ILECs and the Advanced Services Affiliates are conducted on a nondiscriminatory basis. Inquired and documented SBC's response that employees receive training on procedures to ensure transactions between the ILECs and the Advanced Services Affiliates are conducted on a non-discriminatory basis.

## APPENDIX A

- 62) Inquired and documented SBC's response that the ILECs did not use an electronic system to transfer trouble reports to the Advanced Services Affiliates during the Evaluation Period.
- 63) Documented the policies and procedures followed by the ILEC when the customer contacting the ILEC is not a customer of the ILEC, but contacts the SBC ILEC to report trouble affecting an Advanced Service. Noted that such policies and procedures include steps to (1) discover the identity of the Advanced Services provider; (2) refer the customer to the customer's Advanced Services provider, if known, for resolution of the trouble; and (3) prevent the ILEC from using the information obtained as a result of the transfer for any marketing or sales purpose.
- 64) Inquired and documented SBC's response to whether the ILECs or the Advanced Services Affiliates performed the following services during the Evaluation Period:
- Installation of Advanced Services Equipment was performed by AADS in the Former Ameritech States and by the ILECs in the Former SBC States.
  - Connection of Advanced Services Equipment in virtual collocation space was performed by AADS in the Former Ameritech States and by the ILECs in the Former SBC States.
- We were informed that connection of Advanced Services Equipment in physical collocation space did not occur during the Evaluation Period.
- 65) Obtained a list of operations, installation and maintenance ("OI&M") services, by element, offered by certain ILECs to an Advanced Services Affiliate (ASI) in accordance with the transitional mechanisms of the Merger Conditions and to ADSI during the Evaluation Period. Noted these OI&M services were offered to the Advanced Services Affiliates by the ILECs under affiliate agreements.
- 66) Inquired and documented SBC's responses regarding whether the ILECs provided the following services to the Advanced Services Affiliates: 1) determining where, when and how much Advanced Services Equipment needs to be deployed to meet forecasted customer demands, and ensuring equipment compatibility with interconnection services; 2) arranging for purchase of Advanced Services Equipment; 3) arranging and negotiating for collocation space, and arranging for any new Advanced Services Equipment to be delivered; 4) inventorying the Advanced Services Equipment deployed; 5) designing the customer's Advanced Service, including a) identification of Advanced Services network components, unbundled

## APPENDIX A

network elements, telecommunications services and work activities necessary to provision the Advanced Service, b) determination of the routing of the Advanced Service and location(s) of the Advanced Services network components and c) creation of a work order; 6) assignment of the Advanced Services Equipment required; 7) creating and maintaining the customer's record, including the customer's Advanced Service circuit layout record; and 8) ordering from the ILEC the interconnection facilities and telecommunications services required to provision the customer's Advanced Service. For items 1 through 7 above, noted the ILECs provided the above services for ASI in the Former SBC States under the transitional mechanisms in the Merger Conditions. Item 8 above was not applicable in 1999 for ASI. All 8 services were performed by AADS in the Former Ameritech States.

67) Obtained copies of state certifications (where required), tariffs and interconnection agreements and their associated approvals to offer Advanced Services through the separate Advanced Services Affiliates. Also, obtained filings of tariff changes to terminate offering of Advanced Services by the ILECs. Additionally with this data, performed the following procedures:

- Documented the date that the Advanced Services Affiliates filed all required state certifications and interconnection agreements and noted the date was prior to the Merger Close Date in the states where SBC was providing Advanced Services on the Merger Close Date as required by the Separate Affiliate Requirements.
- Documented the date that the Advanced Services Affiliates filed required tariffs to provide non-xDSL Advanced Services in the Former Ameritech States and noted the tariffs were filed no later than five business days after the Merger Close Date.
- Documented that filing of tariffs to provide Advanced Services in the Former SBC States to customers that are providers of Internet services was not required during the Evaluation Period.
- Documented the date that the Advanced Services Affiliates filed tariffs to provide Advanced Services in the Former SBC States to customers that are not providers of Internet services and noted that for those states where certification to provide Advanced Services was received during the Evaluation Period, the tariffs were filed no later than three business days after state approval of Advanced Services Affiliates' certifications to provide Advanced Services in that state.

## APPENDIX A

- Obtained a list of all Advanced Services provided by the ILECs prior to the Merger Close Date, compared this list to the Advanced Services listed in the tariffs filed by the Advanced Services Affiliates, and noted that all services offered by the ILECs prior to the Merger Close Date were included in the tariffs.
  - Documented the date each interconnection agreement between the ILECs and the Advanced Services Affiliates was approved in each state. Noted that interconnection agreements were not approved as of the end of the Evaluation Period in the states of California, Kansas, Nevada, and Texas. For those states in which approval of the interconnection agreement between the ILEC and the Advanced Services Affiliate occurred during the Evaluation Period, obtained documentation that SBC filed interstate tariff changes to terminate the offering of new activations of Advanced Services by the ILECs within three business days of interconnection agreement approval. As disclosed in the Company's annual compliance report dated March 15, 2000, the tariff change to terminate the offering of new activations of Advanced Services by the ILEC in Connecticut was not filed within three business days of December 28, 1999, the date the interconnection agreement was deemed approved as the Company was awaiting receipt of a Certificate of Public Convenience and Necessity from the Connecticut Department of Public Utility Control. This situation is explained in a letter dated February 7, 2000 from Charles Foster to David Solomon and Lawrence Strickling of the FCC.
  - All necessary filings to terminate the offering of new activations of Advanced Services by the ILEC were filed prior to the Merger Close Date in the Ameritech States. However, no filings to terminate the offering of new activations of Advanced Services by the ILECs were filed in the SBC States as all necessary certifications, authorizations, and/or approvals had not been obtained prior to the end of the Evaluation Period.
- 68) Documented the date each Advanced Services Affiliate received approval of its state certifications, interconnection agreements and tariffs.

For the SBC States, we noted that there were no new customer activations during the Evaluation Period.

For the Ameritech States, obtained from the Advanced Services Affiliate a customer list of all new activations of non-xDSL Advanced Services by state during the Evaluation Period. This list included the date that service began for each customer.

## APPENDIX A

For the Ameritech States, obtained from the Advanced Services Affiliate a customer list of all new activations of xDSL Advanced Services by state during the Evaluation Period. This list included the date that service began for each customer.

- 69) For the Ameritech States, reviewed the ILECs' non-xDSL Advanced Services USOC codes by state and noted one USOC code associated with non-xDSL Advanced Services. Developed and executed a query of the ILECs' order database and noted that no orders for non-xDSL Advanced Services were placed after the Merger Close Date.
- 70) For the Ameritech States, reviewed the ILECs' xDSL Advanced Services USOC codes by state and noted two USOC codes associated with xDSL Advanced Services. Developed and executed a query of the ILECs' order database and noted that no orders for xDSL Advanced Services were placed after the Merger Close Date.
- 71) Reviewed the certificates of incorporation and bylaws of the Advanced Services Affiliates and determined that each Advanced Services Affiliate was established prior to the Merger Close Date in each of the SBC States.
- 72) Obtained and documented the names of the employees for the parties that negotiated the interconnection agreements in each of the Former SBC States on behalf of the ILECs and the Advanced Services Affiliates.
- 73) Reviewed the interconnection agreements between the ILECs and the Advanced Services Affiliates as of December 31, 1999 and noted that the ILECs did not make surrogate line sharing discounts available to the Advanced Services Affiliates.
- 74) Inquired and noted interim line sharing as defined in the Separate Affiliate Requirements was not provided to the Advanced Services Affiliates by the ILECs during the Evaluation Period.
- 75) Obtained the methodology used to calculate annual bonuses for officers and management employees of the Advanced Services Affiliates during the Evaluation Period. Determined that the methodology used was tied to the performance of the Advanced Services Affiliates. Obtained the actual calculations used to determine the annual bonuses paid for the year ended December 31, 1999 to all officers and senior managers and a random sample of 30 middle- and lower-level managers. Noted that the actual bonuses paid were consistent with the methodology provided.

## APPENDIX B

### Definitions

- 1) **Advanced Services** – means intrastate or interstate wireline telecommunications services, such as ADSL, IDSL, xDSL, Frame Relay, Cell Relay and VPOP-Dial Access Service (an SBC Frame Relay-based service), that rely on packetized technology and have the capability of supporting transmission speeds of at least 56 kilobits per second in both directions. This definition of advanced services does not include (1) data services that are not primarily based on packetized technology, such as ISDN, (2) x.25-based and x.75-based packet technologies or (3) circuit switched services (such as circuit switched voice grade service) regardless of the technology, protocols or speeds used for the transmission of such services.
- 2) **Advanced Services Affiliate(s)** – includes the following companies, individually or collectively: Ameritech Advanced data services of Indiana, Inc., Ameritech Advanced data services of Illinois, Inc., Ameritech Advanced data services of Ohio, Inc., Ameritech Advanced data services of Michigan, Inc. and Ameritech Advanced data services of Wisconsin Inc. (collectively “AADS”) and SBC Advanced Solutions Inc. (“ASI”).

Additionally, for purposes of the agreed-upon procedures testing and writing of this report only, SBC Advanced Data Services, Inc. (“ADSI”) is referred to as an Advanced Services Affiliate although it has not been designated as an Advanced Services Affiliate by SBC.

*Note:* ADSI was merged into ASI on December 20, 1999. As directed by SBC and the FCC, ADSI was included in the testing performed on the Advanced Services Affiliates for the procedures in Appendix A: 1, 2, 3, 4, 5, 9, 10, 12, 13, 16, 17, 18, 19, 25, 27, 28, 29, 30, 31, 34 and 57.

The inclusion of ADSI in the testing approach, as well as in the definition of “Advanced Services Affiliate” for purposes of this report only, is not meant to imply Ernst & Young has reached any determination that ADSI is a “Separate Advanced Services Affiliate” as defined in the Merger Conditions.

## APPENDIX B

- 3) **Advanced Services Equipment** – includes: 1) DSLAMs or functionally equivalent equipment, 2) spectrum splitters that are used solely in the provision of advanced services, 3) packet switches and multiplexers such as ATMs and Frame Relay engines used to provide advanced services, 4) modems used in the provision of packetized data and 5) DACS frames used only in the provision of advanced services. Advanced services equipment does not include: 1) DACS frames used for voice services, 2) spectrum splitters (or the equivalent functionality) used to separate the voice grade channel from the advanced services channel or 3) spectrum splitters installed after the Merger Close Date that are located at the customer premises.
- 4) **Ameritech States** – Illinois, Indiana, Michigan, Ohio and Wisconsin
- 5) **Assets** – is defined as equipment, software, customer accounts, initial capital contribution and real estate.
- 6) **ILECS** – means Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, Wisconsin Bell, Inc. (collectively “Ameritech”), Pacific Bell Telephone (“Pacific”), The Southern New England Telephone Company (“SNET”), Southwestern Bell Telephone Company (“SWBT”), Nevada Bell and any successor or assign of such company that provides wireline telephone exchange service.
- 7) **Merger Close Date** – October 8, 1999
- 8) **Merger Conditions** – Appendix C of the FCC’s Order approving the SBC/Ameritech Merger – Applications of Ameritech Corp. and SBC Communications Inc. for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Section 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commissions Rules, CC Docket No. 98-141, Memorandum Opinion and Order, 14 FCC Rcd 4761 (1999).



## APPENDIX B

- 9) **Official Services** – means those services permitted by the United States District Court for the District of Columbia in *United States v. Western Elec. Co. Inc.* See 569 F. Supp. 1057, 1098, n.179 (1983) (defined as “communications between personnel or equipment of an Operating Company located in various areas and communications between Operating Companies and their customers”), and its progeny. See also *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 22008, 22054 (1996); cf. *Petition of U S West Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, CC Docket 97-172, Memorandum Opinion and Order, paras. 21-22 (FCC 99-133) (Sept. 27, 1999).
- 10) **SBC States** – Arkansas, California, Connecticut, Illinois, Indiana, Kansas, Michigan, Missouri, Nevada, Ohio, Oklahoma, Texas and Wisconsin